Supreme Court, U.S.
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No. _____

In the Supreme Court of the United States

NANCY J. HUKKANEN-CAMPBELL,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the Tenth Circuit erred in holding, in conflict with the Fifth, Sixth, and Eleventh Circuits, that contingent attorneys' fees paid by a defendant directly to the attorneys of a prevailing plaintiff under Title VII of the Civil Rights Act of 1964 constitute taxable income to the plaintiff, thereby triggering alternative minimum tax liability.

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PETITION FOR A WRIT OF CERTIORARI

Nancy J. Hukkanen-Campbell respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Tenth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-5a) is reported at 274 F.3d 1312. The opinion of the United States Tax Court (App., *infra*, 6a-18a) is a memorandum decision, T.C. Memo. 2000-180 (June 12, 2000), not officially reported, but available at 79 T.C.M. (CCH) 2122 (2000).

JURISDICTION

The judgment of the court of appeals was entered on December 19, 2001. App., *infra*, 1a. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED IN THIS CASE

The principal federal statute involved in this case is section 61(a) of the Internal Revenue Code of 1986, as amended and in effect in 1993 (the "Code"):

> (a) GENERAL DEFINITION.—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:
>
> (1) Compensation for services, including fees, commissions, fringe benefits, and similar items;
> (2) Gross income derived from business;
> (3) Gains derived from dealings in property;
> (4) Interest;
> (5) Rents;

(6) Royalties;
(7) Dividends;
(8) Alimony and separate maintenance payments;
(9) Annuities;
(10) Income from life insurance and endowment contracts;
(11) Pensions;
(12) Income from discharge of indebtedness;
(13) Distributive share of partnership gross income;
(14) Income in respect of a decedent; and
(15) Income from an interest in an estate or trust.

26 U.S.C. § 61(a). This case also tangentially involves the alternative minimum tax provisions of the Code, 26 U.S.C. §§ 55-59, and the fee-shifting provisions of Title VII of the Civil Rights Act of 1964, 42 U.S.C. § 2000e-5(k).

STATEMENT OF THE CASE

This case presents a recurring question of significant importance in the tax law. It involves the 1993 Federal income tax liability of Petitioner Nancy J. Hukkanen-Campbell ("Ms. Hukkanen") on amounts paid by her former employer in connection with Ms. Hukkanen's successful sexual harassment lawsuit brought under Title VII of the Civil Rights Act of 1964. The outcome of this case affects a broad class of taxpayers that includes a large number of individual plaintiff-taxpayers who prevail in lawsuits that give rise to substantial taxable recoveries and attorney's fees.

A. Factual Background

From 1981 to 1984, Ms. Hukkanen was subjected to sexual harassment on a regular basis by her former employer. Ex. 5-J

at 47.[1/] After filing a complaint with the Equal Employment Opportunity Commission ("EEOC"), Ms. Hukkanen retained attorney Fred Petzold and three other attorneys through a contingent fee agreement, under which the attorneys were entitled to receive the greater of (a) 45 percent of the recovery, (b) $125 per hour, or (c) any court awarded fee, plus costs. The contingent fee agreement also granted the attorneys a lien on the claim for the amounts payable to them under the agreement. App., *infra*, 8a; Ex. 8-J at 285.

Ms. Hukkanen obtained a "right-to-sue" letter from the EEOC in February 1990, soon after retaining her attorneys and being informed that she could request such a letter. Ex. 8-J at 286. Mr. Petzold filed a complaint on Ms. Hukkanen's behalf with the District Court for the Western District of Missouri, alleging that she was constructively discharged from her employment in violation of Title VII of the Civil Rights Act of 1964, Pub. L. No. 88-352, § 701 *et seq.* ("Title VII"). Ex. 4-J.

After a bench trial on February 13, 1992 and a hearing on March 31, 1992, the district court found that the sexual harassment had resulted in Ms. Hukkanen's constructive termination in violation of Title VII. Ex. 5-J at 45-52. On April 3, 1992, the district court entered its Final Judgment, awarding Ms. Hukkanen: (1) $55,492 in back pay; (2) $82,534.81 in pension benefits; and (3) $44,418.06 in front pay. App., *infra*, 7a; Ex. 6-J at 1-2.

The district court also awarded "a reasonable attorney's fee" in the amount of $85,227.50 pursuant to the fee-shifting provision of Title VII, 42 U.S.C. § 2000e-5(k). This award included a multiplier of three times the lodestar amount "to

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1 References to "Ex." are to the Tax Court joint exhibits, which were part of the record on appeal to the Tenth Circuit.

compensate plaintiff's attorney for the risk incurred by him in agreeing to represent [Ms. Hukkanen] and pursuing her claim with only a contingent fee arrangement." Ex. 6-J at 2. The Court of Appeals for the Eight Circuit affirmed the district court's decision in all respects, except that it reversed the district court's enhancement for risk of loss of the attorneys' fees portion of the award. Ex. 8-J at 287.

On December 21, 1993, the defendant in Ms. Hukkanen's Title VII action paid $150,000 in partial satisfaction of that judgment, issuing a check in that amount payable to Ms. Hukkanen and two of her attorneys. Ms. Hukkanen and her attorneys executed a schedule detailing the disbursement of the $150,000 payment. The total disbursed to Ms. Hukkanen's attorneys was $73,399.25. She received the remainder, $76,600.75. App., *infra*, 1a; Ex. 9-J.

B. Tax Treatment and Statutory Background

Ms. Hukkanen timely filed her 1993 Federal income tax return and paid $20,075 in tax on the $76,601 she received.[2/] On April 16, 1998, the Commissioner of Internal Revenue issued a statutory notice of deficiency ("Notice") to Ms. Hukkanen. The Notice determined a deficiency of $17,402 in her 1993 taxable year attributable to the operation of the alternative minimum tax. App., *infra*, 2a.

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2 Ms. Hukkanen calculated her tax due by reporting the $150,000 as income and deducting the $73,399 in attorneys' fees in full, which, in the absence of the alternative minimum tax, is the functional equivalent of reporting only the $76,601 she received. The $20,075 in tax she paid on that $76,601 can be calculated by subtracting the tax she calculated to be due on an amended return she later filed (Ex. 2-J), which excluded the lawsuit proceeds from her income entirely, from the tax she calculated to be due on her original return (Ex. 1-J).

The alternative minimum tax, 26 U.S.C. §§ 55-59, applies to taxpayers whose "alternative minimum taxable income" exceeds an exemption amount. 26 U.S.C. § 55(b)(1)(A). "Alternative minimum taxable income" is defined as "taxable income" reduced by only a limited list of deductions. 26 U.S.C. § 55(b)(2). One category of deductions not allowed in computing alternative minimum taxable income is "miscellaneous itemized deductions"—a "catch-all" category. 26 U.S.C. §§ 56(b)(1)(A)(i), 67(b). Deductions for attorney's fees paid fall into this disallowed category.

The alternative minimum tax therefore only applies to the extent a taxpayer receives "taxable income." "Taxable income" is defined in the Code as "gross income" less certain deductions. 26 U.S.C. § 63(a). "Gross income" is defined generally as "all income from whatever source derived." 26 U.S.C. § 61(a).

The Commissioner of Internal Revenue's Notice treated the entire $150,000 paid by the Title VII defendant as taxable income to Ms. Hukkanen, and disallowed most of the deduction for attorneys' fees paid pursuant to the alternative minimum tax provisions outlined above. Ex. 3-J. The amount of tax Ms. Hukkanen paid upon filing her original 1993 Federal income tax return was the same as that which would be calculated by including only the $76,601 she actually received in her income.

The operation of the detailed statutory provisions of the alternative minimum tax has never been disputed. Rather, the point of disagreement between Ms. Hukkanen and the Internal Revenue Service was, and continues to be, whether the $73,399 of the Title VII defendant's $150,000 payment retained by Ms. Hukkanen's attorneys constitutes "income" to her under 26 U.S.C. § 61(a).

C. Proceedings Below

On July 13, 1998, Ms. Hukkanen timely petitioned the United States Tax Court to review the deficiency in tax asserted in the Notice.[3] The Tax Court upheld the deficiency, issuing an opinion on June 12, 2000 (App., *infra*, 6a-18a) and entered its decision in favor of the Commissioner of Internal Revenue on June 13, 2000. Ms. Hukkanen filed a timely notice of appeal from that decision on September 8, 2000.[4] App., *infra*, 2a.

A panel of the Tenth Circuit affirmed the Tax Court's decision in a published opinion issued December 19, 2001. The court summarily concluded that "[t]he $150,000 [Ms. Hukkanen] recovered in her Title VII suit clearly constitutes income from 'whatever source derived.'" *Ibid.* While the court cited the decisions of the three circuit courts of appeals that have reached the opposite result, it noted that "the majority of the circuits have rejected" the argument that contingent attorneys' fees paid directly to attorneys do not constitute income to those attorneys' clients, citing decisions of four circuits holding against taxpayers on this issue. *Id.* at 3a.

The Tenth Circuit distinguished two of the three conflicting circuit decisions[5] based upon perceived, but

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3 The Tax Court had jurisdiction to review the asserted deficiency pursuant to 26 U.S.C. §§ 6123(a), 6214(a) and 7742.

4 The Tenth Circuit had jurisdiction under 26 U.S.C. § 7482(a)(1). App., *infra*, 2a.

5 The Tenth Circuit declined to follow the other contrary circuit court of appeals decision holding in favor of taxpayers on this issue, a recent decision of the Fifth Circuit, based on (a) that court's statement that it was bound by previous precedent and was not deciding the case as an original matter; and (b) purportedly widespread criticism of the decision, citing

unarticulated, differences in the applicable State attorney lien statutes (*ibid.*), but also stated that "[t]he Tax Code mandates this result [*i.e.*, inclusion of the attorneys' fees in the plaintiff's income] irrespective of a particular state's attorney lien statute's provisions." *Id.* at 4a. The court agreed with Ms. Hukkanen "that a universal standard independent of the 'intricacies of any attorney's bundle of rights,' or the unique provisions of a particular state's attorney lien statute is desirable." However, contrary to Ms. Hukkanen's arguments, the Tenth Circuit concluded that the Code required inclusion of the attorneys' fees in Ms. Hukkanen's taxable income. *Ibid.*

REASONS FOR GRANTING THE PETITION

This Court should review the Tenth Circuit's decision because the circuits are split over the recurring issue of whether contingent attorneys' fees paid by a defendant to the attorneys of a prevailing Title VII plaintiff constitute taxable income to the plaintiff, and because the Tenth Circuit's analysis is inconsistent with this Court's decisions defining the scope of the term "income" in the Code.

In determining that the attorneys' fees paid to Ms. Hukkanen's attorneys constitute income to her, the Tenth Circuit failed to apply the extensive framework for determining the boundaries of taxable "income" developed in decades of decisions of this Court and inferior courts. Under those decisions, only income that is sufficiently within a taxpayer's dominion and control can be charged to the taxpayer as income.

The contingent attorneys' fees in this case were outside of Ms. Hukkanen's control. She did not receive the attorneys'

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one law review article. App., *infra*, at 4a.

fees portion of the judgment, nor could she ever have received it. Rather, the attorneys' fees portion of the Title VII award was properly taxable to her attorneys, who had an undisputed right to the proceeds, and who were the principal force behind the generation of that income. The Tenth Circuit erred in deviating from the well-established tests for allocating income to he who earned it. A proper application of those tests to the issue raised by Ms. Hukkanen's case results in the appropriate outcome—that reached by the Fifth, Sixth, and Eleventh Circuits—that the attorneys' fees paid by the Title VII defendant directly to her attorneys are not income to Ms. Hukkanen.

I. THIS COURT SHOULD RESOLVE THE CONFLICT AMONG THE CIRCUITS OVER THE TAX STATUS OF CONTINGENT ATTORNEY'S FEES AS INCOME TO THE ATTORNEY'S CLIENT.

The Tenth Circuit's opinion cites the decisions of three circuits holding that contingent attorney's fees do not constitute income to a successful plaintiff. App., *infra*, 3a. The Tenth Circuit, however, declined to follow those decisions, opting instead to adopt the position of other circuits charging income to plaintiffs whose attorneys are paid directly by lawsuit defendant. *Ibid.* As a result of the split among the circuits recognized by the Tenth Circuit, a taxpayer's liability for Federal income tax varies depending upon the circuit in which she resides at the time she files a Tax Court petition.[6] This Court should resolve this conflict among the circuits to

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6 The circuit in which a taxpayer resides at the time she files a petition with the Tax Court determines the circuit court of appeals where venue is appropriate for an appeal of the Tax Court's decision. 26 U.S.C. § 7482(b)(1)(A). The Tax Court applies the law of the circuit to which an appeal lies under the "*Golsen* doctrine." See *Golsen v. Commissioner*, 54 T.C. 742, 756-757 (1970), *aff'd*, 445 F.2d 985 (10th Cir. 1971).

promote uniformity in the application of the Federal income tax laws and to discourage forum shopping.

A. The Tenth Circuit's Decision in this Case Directly Conflicts With Recent Decisions of the Fifth, Sixth, and Eleventh Circuits.

1. Circuits reaching the opposite conclusion to that of the Tenth Circuit

The first case to address whether contingent attorney's fees constitute income to the attorney's client was *Cotnam v. Commissioner*, 263 F.2d 119 (5th Cir. 1959). In *Cotnam*, the plaintiff, Mrs. Cotnam, successfully sued the estate of T. Shannon Hunter, who had promised her one-fifth of his estate in exchange for her services as his attendant for the remainder of his life. Mrs. Cotnam was awarded $120,000, of which she paid $50,365.83, representing a 40 percent contingent fee, plus costs, to her attorneys. *Id.* at 120.

The Fifth Circuit held that the $50,365.83 in attorneys' fees was income to the attorneys, but not to Mrs. Cotnam. 263 F.2d at 125-126. As a result, Mrs. Cotnam was taxable only on the net amount of her award. The court explained:

> The only income, the only real economic benefit, which Mrs. Cotnam ever received was the $75,254.17 which she collected. (In our opinion, it is as illegal as it is unjust to tax her on the remaining $50,365.83 which did not pass through her hands and of which she never had control.) In a realistic sense the remaining $50,365.83 was income of the attorneys, not of Mrs. Cotnam.

Id. at 126.[7]

The Fifth Circuit recently reaffirmed the holding of *Cotnam* in *Srivastava v. Commissioner*, 220 F.3d 353 (5th Cir. 2000). In *Srivastava*, the Fifth Circuit dispelled the notion that its decision in *Cotnam* turned upon the peculiarities of the attorney lien statute that applied to Mrs. Cotnam's fee agreement with her attorneys (that of Alabama): "Whatever are the attorney's rights against the defendant under Texas law as opposed to Alabama law, the discrepancy does not meaningfully affect the economic reality facing the taxpayer." *Id.* at 364. The Fifth Circuit expressly declined the Commissioner's invitation to overrule *Cotnam* and held that the attorney's fee portion of the taxpayer's award was not taxable as income to him. *Id.* at 365.

The Eleventh Circuit has similarly recently reaffirmed the holding of *Cotnam* in *Barlow-Davis v. Commissioner*, 210 F.3d 1346 (11th Cir. 2000). In *Barlow-Davis*, the Eleventh Circuit also declined the Commissioner of Internal Revenue's invitation to overrule *Cotnam*. *Id.* at 1347 n.4; see also *Foster v. United States*, 249 F.3d 1275, 1280-1281 (11th Cir. 2001) (awarding attorney's fees to taxpayer because Internal Revenue Service's position that attorney's fees constituted income to the successful plaintiff was "not substantially justified" in light of *Barlow-Davis* and *Cotnam*). Thus, a taxpayer residing in the Eleventh Circuit at the time she files her Tax Court petition, unlike a taxpayer, like Ms. Hukkanen,

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7 The Fifth Circuit has stated that "[t]he additional language offered by Judges Rives and Brown offers the best insight into the majority's reasoning." *Srivastava v. Commissioner*, 220 F.3d 353, 363 n.31 (5th Cir. 2000) (referring to the language quoted above).

residing in the Tenth Circuit, need not include fees received by her attorneys in her taxable income.[8]

The Sixth Circuit has also weighed in on the question of the tax treatment of contingent attorney's fees, and, like the Fifth and Eleventh Circuits, has rejected the Commissioner's argument that contingent attorney's fees paid by a defendant directly to a plaintiff's attorney constitute taxable income to the plaintiff. In *Estate of Clarks v. United States*, 202 F.3d 854 (6th Cir. 2000), the court was faced with the question of whether attorneys' fees attributable to the taxable interest component of a non-taxable award should be included in the successful plaintiff's income. Contrary to the Tenth Circuit's holding in this case, the Sixth Circuit held that the attorneys' fees portion was not income to the plaintiff-taxpayer. *Id.* at 857-858.

The Sixth Circuit held that a client who enters into a contingent fee arrangement with an attorney in order to pursue a claim has "lost his right to receive payment for the lawyer's portion of the judgment." 202 F.3d at 856. The court relied upon this effect of the contingent fee arrangement, combined with the speculative nature of the attorneys' engagement, in holding that the fees did not constitute income to the taxpayer, explaining:

> In the instant case, as in *Cotnam*, the value of taxpayer's lawsuit was entirely speculative and dependent on the services of counsel. The claim simply amounted to an intangible, contingent expectancy. The only economic benefit Clarks could derive from his claim against the

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8 The Tax Court has recognized the Eleventh Circuit's reaffirmation of *Barlow-Davis* and has applied its holding to cases appealable to that circuit under the *Golsen* doctrine (see *supra*, n.6) in *Griffin v. Commissioner*, T.C. Memo. 2001-5 (2001).

> defendant in state court was to use the contingent part of it to help him collect the remainder. Like an interest in a partnership agreement or joint venture, Clarks contracted for services and assigned his lawyer a one-third interest in the venture in order that he might have a chance to recover the remaining two-thirds. Just as in *Cotnam*, the assignment Clarks' lawyer received operated as a lien on a portion of the judgment sought to be recovered transferring ownership of that portion of the judgment to the attorney.

Estate of Clarks, 202 F.3d at 857. The court went on to explain why the execution of a contingent fee contract did not constitute an ineffective (for tax purposes) anticipatory assignment of income, stating that when the taxpayer engaged the attorneys, "there was no res, no fund, no proceeds, no vested interest, only a hope to receive money from the lawyer's efforts and the client's right, a right yet to be determined by judge and jury." *Ibid.*

All five of these decisions, *Cotnam*, *Srivastava*, *Barlow-Davis*, *Foster* and *Estate of Clarks*, from three different circuit courts of appeals, the Fifth, Sixth, and Eleventh Circuits, are directly contrary to the Tenth Circuit's holding in this case.

2. *Circuits, besides the Tenth Circuit, reaching the opposite conclusion of that of the Fifth, Sixth, and Eleventh Circuits*

The Tenth Circuit is not the first circuit to reach a conclusion at odds with the first decision addressing the tax treatment of contingent attorney's fees, the Fifth Circuit's decision in *Cotnam*. The Tenth Circuit cited decisions of four such circuits in its opinion. App., *infra*, 3a, citing *Kenseth v. Commissioner*, 259 F.3d 881 (7th Cir. 2001); *Young v. Commissioner*, 240 F.3d 369 (4th Cir. 2001); *Coady v.*

Commissioner, 213 F.3d 1187 (9th Cir. 2000); and *Baylin v. United States*,[9] 43 F.3d 1451 (Fed. Cir. 1995).

With the exception of the Federal Circuit's opinion in *Baylin*, which failed to cite or acknowledge the contrary precedent of *Cotnam*, each of the cases cited by the Tenth Circuit acknowledged that there was a conflict among the circuits. See *Kenseth*, 259 F.3d at 883 ("The circuits are split on whether a contingent fee is, as the Tax Court held in this case, a part of the client's taxable income"); *Young*, 240 F.3d at 377-379 (explicitly rejecting *Cotnam* and *Estate of Clarks* and adopting the "majority" view); *Coady*, 213 F.3d at 1188-1190 (noting that "[t]he rule in *Cotnam* has been subject to disagreement among the circuit courts of appeals," and adopting approach of *Baylin*).

3. The split among the circuits is not attributable to differences in State law.

The Tenth Circuit opinion demonstrates some confusion about the role of State law in the Federal income tax determinations at issue in this case. On the one hand, the Tenth Circuit distinguished *Cotnam* and *Estate of Clarks* as cases in which a different State's law governed the scope of the attorney's lien created by a contingent attorney's fee contract. App., *infra*, at 3a. On the other hand, the court "agree[d] with Petitioner that a universal standard independent of the 'intricacies of any attorney's bundle of rights,' or the unique provisions of a particular state's attorney lien statute is desirable." *Id.* at 4a.

Despite the Tenth Circuit's apparent confusion, courts on both sides of the issue have nearly universally agreed that the

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9 The Tenth Circuit incorrectly lists the title of this case as *Baylin v. Maryland*. App., *infra*, 3a.

cases do not turn on State law. The Tenth Circuit itself quoted the relevant language from *Srivastava*, where the court declined to distinguish *Cotnam* on the basis of "the intricacies of an attorney's bundle of rights against the opposing party under the law of the governing state." App., *infra*, at 4a, quoting *Srivastava*, 220 F.3d at 364. After examining the *Cotnam* opinion and rationale, the Fifth Circuit in *Srivastava* declined the Commissioner's invitation to distinguish *Cotnam* on State law grounds, holding that distinctions regarding the scope of an attorney's power to enforce his rights "should not affect the analysis required by the anticipatory assignment of income doctrine, which looks to the taxpayer's degree of control and dominion over the asset." *Srivastava*, 220 F.3d at 363-364; see also *Estate of Clarks*, 202 F.3d at 857-858 (holding for taxpayer on this issue without relying on specific operation of State law).

Most courts reaching the same conclusion as the Tenth Circuit have been careful to explain that their decisions have not been based on differences in State law. For example, the Fourth Circuit, in holding against the taxpayer on the issue raised in this case, concluded that:

> As the Fifth Circuit itself has now recognized [in *Srivastava*], whether amounts paid directly to attorneys under a contingent fee agreement should be included within the client's gross income should be resolved by proper application of federal income tax law, not the amount of control state law grants to an attorney over the client's cause of action.

Young, 240 F.3d at 378-379; see also *Sinyard v. Commissioner*, 268 F.3d 756, 760 (9th Cir. 2001) (rejecting *Cotnam* and stating that "we do not see how the existence of a lien in favor of the taxpayer's creditor makes the satisfaction

of the debt any less income");[10] *cf. Kenseth*, 259 F.3d at 883-884 (relying solely on principles of Federal tax law in reaching conclusion).

The reason for courts' refusal to rely on State law in determining the Federal income tax consequences of contingent attorney's fee arrangements is plain. A State-by-State standard would require *every* circuit court of appeals to decide the tax effect of *every* State's law. See note 6, *supra*. The proper Federal income tax treatment of contingent attorney's fee arrangements requires interpretation and application of the Internal Revenue Code. The conflict among the circuits cannot be explained as being attributable to difference in State law.

B. Resolution of the Conflict among the Circuits Is Necessary to Promote Uniform Application of the Federal Income Tax Laws on an Important and Recurring Issue.

Under the current state of the law, as established by the decisions of the Tax Court and the various courts of appeals, the tax status of contingent attorney's fees depends upon the taxpayer's circuit of residence at the time she files a Tax Court petition. If the taxpayer lives in the Fifth, Sixth, or Eleventh Circuit, she does not recognize income on a defendant's payment made directly to her attorneys. The same taxpayer

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10 Prior to its decision in *Sinyard*, it appears that the Ninth Circuit employed a State-by-State approach that required a decision regarding the Federal income tax effect of each State's attorney lien law. See *Benci-Woodward v. Commissioner*, 219 F.3d 941 (9th Cir. 2000) (relying on differences in California law); *Coady*, 213 F.3d at 1190 (relying on differences in Alaska law). The Ninth Circuit's statement in *Sinyard* indicates a departure from this previously-held view.

would recognize income if she lived elsewhere in the Nation on the petition filing date.[11/]

This situation is contrary to the principle that the Federal income tax laws should be applied uniformly, independent of geographic distinctions. The granting of Ms. Hukkanen's request for a writ of certiorari in this case would promote this desired uniformity. See, *e.g.*, *Turnbow v. Commissioner*, 368 U.S. 337, 339 (1961) (certiorari granted "on a matter of importance to the proper interpretation and uniform application of the Internal Revenue laws").

The issue upon which the circuits are split is a recurring and important question. Obviously, many individuals, like Ms. Hukkanen, retain attorneys on a contingent fee basis and successfully recover taxable damages from defendants. The inclusion of the attorney's fees portion of any recoveries under these agreements in the successful plaintiff's income often triggers alternative minimum tax liability, since any deduction for attorney's fees paid is likely to be large in relation to the taxpayer's income for the year of recovery. These results can be devastating. As Judge Beghe of the Tax Court has observed, "in cases in which the aggregate fees exceed 72-73 percent of the recovery, the [alternative minimum] tax can exceed the net recovery, resulting in an overall effective rate of tax that exceeds 100 percent of the net recovery." *Kenseth*, 114 T.C. at 421, 425-26 (Beghe, J., dissenting).

The circuit split has been widely recognized and the desirability of Supreme Court resolution of the issue has been

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11 In cases appealable to circuits that have not directly addressed the issue raised by this case, the Tax Court has declined to apply the analysis of the Fifth, Sixth, and Eleventh Circuits, holding that the attorney's fees are income to the attorney's client. See, *e.g.*, *Kenseth v. Commissioner*, 114 T.C. 399 (2000), *aff'd*, 259 F.3d 881 (7th Cir. 2001).

noted by many commentators. See, *e.g.*, Stephen D. Feldman, *Exclusion of Contingent Attorneys' Fees from Gross Income*, 68 U. CHI. L. REV. 1309, 1336 (2001) ("To resolve the circuit split and create a uniform doctrine, courts should permit exclusion of contingent attorneys' fees from a plaintiff's gross income in all cases"); Lauren E. Sheridan, *Trees in the Orchard or Fruit from the Trees?: The Case for Excluding Attorneys' Contingent Fees from the Client's Gross Income*, 36 GA. L. REV. 283, 287 (2001) ("There remains a deep split between the federal courts of appeal regarding the taxation of attorneys' contingent fees to clients"); Benjamin C. Rasmussen, *Taxation of an Attorney's Contingency Fee of a Punitive Damages Recovery: The* Srivastava *Approach*, 15 BYU J. PUB. L. 301, 301 (2001) ("Recently, a noticeable split has occurred in the federal circuit courts * * * . This dispute between the circuits seems ripe for determination by the United States Supreme Court").

The importance of the issue and the harsh effects of the result reached by the Tenth Circuit in this case have also received national media attention. See, *e.g.*, David Cay Johnston, *A "Stealth Tax" Is Creeping Up on Growing Numbers of Americans*, N.Y. TIMES, Feb. 17, 2002, Sec. 3, at 17; see also Doug Clark, *Hero Fought Off One Robber, Now Facing IRS*, SPOKANE SPOKESMAN-REVIEW, Apr. 29, 2001, at B1 (describing alternative minimum tax application to contingent attorneys fees and concluding that "[a]s crazy as it sounds, however, this AMT business all depends on your address"); Tom Herman, *Tax Report*, WALL ST. J., Aug. 2, 2000, at A1 (labeling the circuit split on this issue "a confusing jumble that the Supreme Court may have to untangle").

The resolution of the split among the circuits is crucial to the uniform application of the Federal tax laws in an important

area of tax law. This Court should grant the petition for a writ of certiorari to settle the issue.

II. THIS COURT SHOULD REVERSE THE TENTH CIRCUIT'S ERRONEOUS APPLICATION OF THE TESTS FOR INCOME RECOGNITION ESTABLISHED BY THIS COURT'S DECISIONS.

The Tenth Circuit's decision in this case is contrary to the tests for income recognition developed by this Court over the decades. Although the Tenth Circuit failed to even mention any of this Court's decisions defining the boundaries of "income," the court of appeals' rationale is contrary to those decisions. The Tenth Circuit summarily rejected Ms. Hukkanen's argument that she cannot be charged with income because she lacked the requisite dominion and control of the attorneys' fees portion of the lawsuit proceeds. App., *infra*, 3a. Because the Tenth Circuit's summary conclusion is contrary to this Court's decisions, this Court should grant the petition for a writ of certiorari and reverse that court's decision.

A. Under the Tests for Income Recognition Established by this Court's Opinions, the Attorneys' Fees Paid to Ms. Hukkanen's Attorneys Do Not Constitute Income to Her.

It is well-established that income cannot be attributed to a taxpayer who does not have a high degree of control over the source of the income. In retaining attorneys through a contingent fee arrangement, Ms. Hukkanen relinquished the control necessary to saddle her with the income tax burdens of the attorneys' fees portion of the proceeds. Her attorneys, by the contingent fee contract and the relevant attorney lien statute, obtained a property interest—a lien on the sexual harassment cause of action. Her attorneys had practical control over the cause of action, which had not ripened into a

valuable right prior to their intervention in the sexual harassment dispute. When the lawsuit defendant tendered a check made payable to the attorneys and Ms. Hukkanen, Ms. Hukkanen had no power to divest the attorneys of their portion of the payment. Accordingly, the attorneys' fees portion of the payment did not constitute income to Ms. Hukkanen.

1. Income cannot be attributed to a taxpayer who does not have control over the source of the income.

This Court has clearly established that unfettered control is the hallmark of income. In determining whether a taxpayer had transferred property or merely the right to receive income, it has explained:

> The crucial question remains whether the assignor retains sufficient power and control over the assigned property or over receipt of the income to make it reasonable to treat him as the recipient of the income for tax purposes.

Commissioner v. Sunnen, 333 U.S. 591, 604 (1948). Similarly, the test has been summarized:

> The income that is subject to a man's unfettered command and that he is free to enjoy at his own option may be taxed to him as his income, whether he sees fit to enjoy it or not.

Corliss v. Bowers, 281 U.S. 376, 378 (1930).

The control test has been used to identify situations where receipt of money does not give rise to income. For example, it is well-established that receipt of a loan does not give rise to income to the borrower because of the obligation to repay the funds. See *Commissioner v. Tufts*, 461 U.S. 300, 307 (1983). However, an advance payment of the purchase price of goods constitutes income to the seller of the goods. In *Commissioner*

v. Indianapolis Power & Light Co., 493 U.S. 203, 208-209 (1990), this Court applied this economic "distinction * * * of degree rather than of kind" by applying a "complete dominion" test to determine whether a taxpayer recognized income. The Court observed that the issue "turns upon the nature of the rights and obligations" of the purported recipient of income. *Id.* at 209. If the funds received are not "'undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion,'" they do not constitute income to the recipient. *Ibid.* (quoting *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955)). The "key" to determining whether a taxpayer enjoys "complete dominion" is "whether the taxpayer has some guarantee that he will be allowed to keep the money." *Indianapolis Power & Light Co.*, 493 U.S. at 210.

As explained in the following section, Ms. Hukkanen did not have complete dominion and control over the portion of the lawsuit proceeds she pledged to her attorneys in the contingent fee agreement. She also was she the indefeasibly vested owner of her attorneys' portion of the award. Amounts over which she did not have complete control should not be included in her income.

2. Ms. Hukkanen did not have the control of the attorneys' fees portion of her lawsuit required to charge her with receipt of income.

Ms. Hukkanen entered into a contingent fee contract with the attorneys who represented her in the sexual harassment lawsuit and subsequent appeal. The contract provided that Ms. Hukkanen's attorneys would receive at least 45 percent of any recovery. Ex. 7-J. The contract also contained the following provision under the heading "Lien On the Claim":

> Attorneys will have a lien of [sic] the claim for the amounts stated above in the event of recovery, or, if no recovery is effected prior to his termination or withdrawal, the lien shall be for $150 per hour for all hours plus all unpaid expenses.

Id. The contractual lien on the cause of action was buttressed by Missouri law.[12]

Ms. Hukkanen's attorneys had a contractual and statutory lien on the attorneys' fees portion of the Title VII cause of action. At the time the defendant tendered a check for $150,000 payable to the attorneys and Ms. Hukkanen, the lien had already attached. Ms. Hukkanen had no legal right to divest her attorneys of their portion of the lawsuit proceeds. The attorneys' fees portion of the $150,000 check was never within Ms. Hukkanen's control. As set forth in the previous section, this absence of complete control mandates that Ms. Hukkanen not be attributed income on account of the payment to her attorneys. See *Corliss*, 281 U.S. at 378 ("income that is subject to a man's unfettered command and that he is free to enjoy at his own option may be taxed to him as his income"). If anyone had "complete dominion" over the attorneys' fees

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12 The applicable Missouri statute provided that:

> The compensation of an attorney or counselor for his services is governed by agreement, express or implied, which is not restrained by law. From the commencement of an action or the service of an answer containing a counterclaim, the attorney who appears for a party has a lien upon his client's cause of action or counterclaim, which attaches to the verdict, report, decision or judgment in his client's favor, and the proceeds thereof in whosoever hands they may come; and cannot be affected by any settlement between the parties before or after judgment.

Mo. Ann. Stat. § 484.130 (West 1987).

portion of the proceeds, it was Ms. Hukkanen's attorneys, not her. See *Indianapolis Power & Light Co.*, 493 U.S. at 209-210.

This Court should grant a writ of certiorari and reverse the Tenth Circuit's misapplication of this Court's precedent. Ms. Hukkanen did not have the control of the attorneys' fees portion of her lawsuit necessary to include those fees in her income.

3. *The assignment of income doctrine is inapplicable to Ms. Hukkanen's retention of attorneys on a contingent fee basis.*

Nothing in the language of the Internal Revenue Code requires that the attorneys' fees portion of the lawsuit proceeds be attributed to Ms. Hukkanen. The only rationale under which the attorneys' fees could represent income to Ms. Hukkanen is the judicial "assignment of income" doctrine. The assignment of income doctrine originated in this Court and has evolved over the past 70 years. See *Helvering v. Eubank*, 311 U.S. 122 (1940); *Helvering v. Horst*, 311 U.S. 112 (1940); *Lucas v. Earl*, 281 U.S. 111 (1930). This Court has noted that the process of applying the assignment of income control test and "drawing the line" between legitimate transfers and assignments of income is "a recurrent difficulty." *Harrison v. Schaffner*, 312 U.S. 579, 583 (1941); see also *Jones v. Commissioner*, 306 F.2d 292, 296 (5th Cir. 1962) ("In seeking to reconcile the implications of the infinite variety of facts presented by the decided cases and all that has been said about the subject of anticipatory assignment of income, one is likely to be displeased with his own wits; and may find his mind teetering between conflicting conclusions").

Courts, regardless of their resolution of the issues, have frequently observed that the application of the assignment of income doctrine to attorneys' fees for alternative minimum tax

purposes produces harsh results. For example, the Tax Court in *Kenseth*, in an 8-5 split decision, held that attorneys' fees should be included in a plaintiff's income, despite acknowledging that "[c]ommentators and courts have long observed [the] potential for unfairness in the operation of the AMT in this [area]." *Kenseth*, 114 T.C. at 407 n.3. The Court of Appeals for the First Circuit has also noted that the application of the alternative minimum tax to individual taxpayers' deduction of legal expenses "smacks of injustice." *Alexander v. IRS*, 72 F.3d 938, 946 (1st Cir. 1995). There is no reason for this Court to perpetuate the injustice acknowledged by the Tax Court in *Kenseth* by applying the judicial assignment of income doctrine to Ms. Hukkanen in this case.

The assignment of income doctrine originated with Supreme Court cases involving intra-family transactions such as *Lucas v. Earl*, *Helvering v. Horst*, and *Sunnen*. In those cases, this Court thwarted taxpayer attempts to shift income within a family group. In *Lucas v. Earl*, the court applied the assignment of income doctrine to a situation in which a husband contracted to give his wife one-half of his future employment income. See 281 U.S. at 114-115. The taxpayer in *Helvering v. Horst* unsuccessfully attempted to shift income by detaching interest coupons from his bonds and giving them as a gift to his son. See 311 U.S. at 114. *Sunnen* involved a husband's transferring patent licensing contracts to his wife. See 333 U.S. at 595.

The assignment of income doctrine is particularly applicable to intra-family transfers because a taxpayer is presumed to retain dominion and control over income that remains within his family. Under such circumstances, the taxpayer is still able to enjoy the full benefit of the income. Stated differently, after an intra-family transfer, the transferor "retains sufficient power and control over the assigned

property or over receipt of the income to make it reasonable to treat him as the recipient of the income for tax purposes." *Sunnen*, 333 U.S. at 604.

Another situation in which retention of control makes the assignment of income doctrine applicable is in assignments of personal services income. Even where a taxpayer assigns the income from his services to an unrelated party, courts tax the income to the person who performed the services and, therefore, earned the income. This treatment is grounded in the policy that the tax law should "tax salaries to those who earned them." *Earl*, 281 U.S. at 114. Thus, courts have not allowed taxpayers to avoid taxation by assigning personal services income. See, *e.g.*, *Eubank*, 311 U.S. at 124 (assigned insurance commissions payable for services rendered are income to transferor).

None of the traditional elements of an assignment of income case are present in Ms. Hukkanen's case. The contingent fee contract she entered into with her attorneys was an arm's-length transaction entered into for legitimate non-tax purposes. She did not perform any of the services from which the attorneys' fees arose, and she lacked the dominion and control over the attorneys' fees portion of the Title VII lawsuit necessary to trigger the inclusion of income. The assignment of income doctrine is therefore inapplicable and the Tenth Circuit's decision should be reversed.

Furthermore, the assignment of income doctrine is inapplicable to situations where the property right assigned is exceedingly contingent or speculative at the time of assignment. For example, in *Cold Metal Process Co. v. Commissioner*, 247 F.2d 864 (6th Cir. 1957), the court was faced with the tax consequences of Cold Metal's transfer of its interest in royalty payments that were being held pending a government cancellation suit seeking to invalidate the patents

at issue. The Sixth Circuit determined that Cold Metal did not recognize income upon the ultimate favorable resolution of the suit with the government and release of the royalties. It reasoned that the assignment of income doctrine did not apply because, at the time of the transfer, the claim for the royalties "was not income to Cold Metal"—"[i]t was an unliquidated chose in action." *Id.* at 872; see also *Jones v. Commissioner*, 306 F.2d 292, 301 (5th Cir. 1962) (where claim at the time of transfer was "uncertain, doubtful and contingent," the transferor had no income upon the subsequent recovery on the claim under the assignment of income doctrine).

The assignment of income doctrine is not applicable to the arm's-length transaction at issue in this case—Ms. Hukkanen's hiring of attorneys on a contingent fee basis. Ms. Hukkanen's claim was worthless without her attorneys' efforts. Even when those attorneys agreed to handle her case on a contingent fee basis, there was no guarantee that Ms. Hukkanen even had a valid claim. The assignment of income doctrine is not applicable to the assignment of speculative, inchoate rights, such as those possessed by Ms. Hukkanen at the time of the purported ineffective assignment. This Court should grant a writ of certiorari in order to correct the Tenth Circuit's (and other courts of appeals') misapplication of this Court's income recognition and assignment of income precedents.

B. The Tenth Circuit's Decision Leads to Absurd Results at Odds with the Legislative Purposes of the Alternative Minimum Tax and Title VII.

In this case, the language used in the statute at issue ("income" in 26 U.S.C. § 61(a)) is far from clear. But, even in situations where the plain language used in a statute *is* clear, it is well-established that a statute should not be construed to produce absurd results. See *United States v. Brown*, 333 U.S.

18, 27 (1948) ("No rule of construction necessitates our acceptance of an interpretation resulting in patently absurd consequences"). The Tenth Circuit's interpretation of section 61 and the alternative minimum tax provisions and application of the judicial assignment of income doctrine leads to absurd results both in this case and when applied to other plaintiff-taxpayers.[13/] These absurd results contravene the legislative purposes of both the alternative minimum tax and Title VII.

The Tax Court and the Tenth Circuit in this case held that the portion of the proceeds paid directly to Ms. Hukkanen's attorneys was taxable to her for purposes of computing her alternative minimum tax liability. If those decisions stand, the $150,000 payment made by the sexual harassment lawsuit defendant will be divided up as follows:

$150,000	Total Payment
-$73,399	Attorneys' Fees
-$20,075	Regular Tax Paid with Return
-$17,402	Additional Tax Attributable to AMT
$39,124	Amount Ms. Hukkanen Received

Under the Tenth Circuit's holding, Ms. Hukkanen will net 26 percent (before considering the substantial accrued interest on the additional tax liability) of the $150,000 payment instead of the 38 percent she would have netted in the absence of the imposition of the asserted alternative minimum tax deficiency. The result of the Tenth Circuit's statutory interpretation is absurd.

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13 This is not a case in which applying a statute written by Congress produces such a result. As explained above, the assignment of income doctrine is a court-fashioned rule. Accordingly, it is clearly within the Court's purview to temper its application to avoid unjust, illogical results.

Even more absurd, however, are the results of the Tenth Circuit's holding when applied to plaintiff-taxpayers whose attorneys retain larger percentage contingent fees. As Judge Beghe noted in his dissent in *Kenseth*, "in cases in which the aggregate fees exceed 72-73 percent of the recovery, the tax can exceed the net recovery, resulting in an overall effective rate of tax that exceeds 100 percent of the net recovery." *Kenseth*, 114 T.C. at 421, 425-426 (Beghe, J., dissenting).

Regardless of the exact calculation, it is certainly possible that plaintiffs could receive a net recovery of less than zero under the Tenth Circuit's methodology. This danger is especially high in discrimination lawsuits, where actual damages may be low but the societal interest in the outcome and corresponding attorneys' fees are high.

The Tenth Circuit's holding in this case is contrary to the legislative purpose of the alternative minimum tax. The current version of the individual alternative minimum tax was enacted as part of the Tax Equity and Fiscal Responsibility Act of 1982. The Senate Finance Committee Report for that act explained the purpose of the revised alternative minimum tax:

> The committee has amended the present minimum tax provisions applying to individuals with one overriding objective: no taxpayer with substantial economic income should be able to avoid all tax liability by using exclusions, deductions and credits. * * * The ability of high-income individuals to pay little or no tax undermines respect for the entire tax system and, thus, for the incentive provisions themselves.

S. REP. NO. 97-494, VOL. 1, at 108 (1982). These purposes were reiterated by Congress when it amended the alternative

minimum tax with the Tax Reform Act of 1986, Pub. L. No. 99-514. See S. REP. NO. 99-313, at 520 (1986).

Ms. Hukkanen is not a "high-income individual" attempting to "avoid" taxation on "substantial economic income" by excluding the payment to her attorneys from her income. First, the payment directly to her attorneys, over which she had no control, did not enhance her financial condition at all. She received no economic income from the payment to her attorneys. Second, Ms. Hukkanen has hardly "avoided" taxation by paying an effective tax rate of 26 percent on the net proceeds of the award, rather than the 49 percent effective rate imposed under the Tax Court's holding.

Ms. Hukkanen paid regular income tax on the amount that was paid to her—her true "economic income." The Tenth Circuit's holding results in her being taxed on the payment by the defendant to her attorneys. This absurd result conflicts with the legislative purpose of the alternative minimum tax and should be reversed.

The Tenth Circuit's decision also undermines the legislative purposes behind Title VII. Title VII of the Civil Rights Act of 1964 was enacted to combat discrimination in employment. See *International Bhd. of Teamsters v. United States*, 431 U.S. 324, 348 (1977). Title VII contains a "fee-shifting" provision, 42 U.S.C. § 2000e-5(k), that was intended to encourage potential plaintiffs to bring meritorious suits.[14/] A Title VII plaintiff such as Ms. Hukkanen acts not just for herself, but also as a "private attorney general," vindicating national policy. See *Newman v. Piggie Park Enters.*, 390 U.S. 400, 402 (1968); see also *Christiansburg Garment Co. v.*

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14 In Ms. Hukkanen's case, the district court awarded $85,227 in attorney's fees under 42 U.S.C.A. § 2000e-5(k). Ex. 6-J at 2. This amount was reduced on appeal. Ex. 8-J.

EEOC, 434 U.S. 412, 418 (1978) (the Title VII plaintiff is the "chosen instrument of Congress to vindicate 'a policy that Congress considered of the highest priority'" (citing *Piggie Park*)). Ms. Hukkanen should not be penalized for assuming this role.

The Tenth Circuit's decision in this case undermines the purpose of Title VII generally and the purpose of the fee-shifting provision of Title VII specifically.[15] By treating plaintiff-taxpayers as receiving income from payments to their attorneys, the Tenth Circuit's holding discourages plaintiffs with meritorious discrimination claims from bringing suit, even when the possibility of an award of attorneys' fees is taken into account. An award of attorneys' fees results in additional tax liabilities for successful plaintiffs under the Tenth Circuit's holding in this case. These additional tax liabilities can easily make meritorious suits economically infeasible to pursue.

In addition to its other errors, the Tenth Circuit's decision leads to absurd results inconsistent with the purpose of the alternative minimum tax and undermines Title VII.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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15 Commentators agree. See, *e.g.*, Laura Sager & Stephen Cohen, *How the Income Tax Undermines Civil Rights Law*, 73 S. CAL. L. REV. 1075 (2000).

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